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Supreme Court, U.S.
FILED
MAY 24 1990
SPANIOL, JR.
CLERK

No. 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1989

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

WILLIAM S. SCHERMAN
General Counsel
Federal Energy Regulatory Commission
Washington, D.C. 20426

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The court of appeals in this case struck down Order No. 451, a major regulatory undertaking by the Federal Energy Regulatory Commission to address the substantial regional inequities, production disincentives, and other distortions that have adversely affected the production and distribution of natural gas, especially "old" gas. We show in the certiorari petition that the court of appeals' decision disregards the express provisions of the Natural Gas Policy Act (NGPA) and the Natural Gas Act (NGA) (Pet. 17-19, 23-24); improperly relies on scattered bits of the NGPA's legislative history, which is in any event fully consistent with Order No. 451 (Pet. 19-22); ignores the requirement under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842-843 (1984), of deference to the administrative interpretation of the Act (Pet. 16-17, 22-23, 25); and con-

flicts with decisions of this Court and the District of Columbia Circuit regarding the scope of the Commission's ratemaking and abandonment authority and the discretion of an agency to address distinct regulatory issues in separate rulemaking proceedings (Pet. 24-26). Respondents for the most part do not defend these aspects of the decision below. Instead, they recharacterize the court's rulings in an effort to downplay their legal significance and stark departure from the statutory text and judicial precedent. This effort is unavailing.

We also have shown (Pet. 26-29) that the court of appeals' ruling is of broad practical significance, because it calls into question the validity of many contracts that were negotiated, renegotiated, or terminated in light of Order No. 451, and threatens widespread disruption and litigation in the natural gas industry. Respondents do not dispute this broad practical importance of the court of appeals' ruling at the present time, but they assert that it will evaporate on January 1, 1993, the effective date of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158. This assertion is without merit, because as we have explained (Pet. 27-29), the decision below repudiates several important premises on which Congress acted in passing the Wellhead Decontrol Act, and the effects of the decision will in any event be felt well after that Act goes into effect.

1. a. Respondents attempt to avoid review of the court of appeals' central holding—that the Commission unlawfully raised the ceiling price of old gas—by entirely recasting the court's rationale. See Br. in Opp. 21-25. The court of appeals held that the Commission did not have authority under Sections 104(b)(2) and 106(c) of the NGPA, 15 U.S.C. 3314(b)(2) and 3316(c), to collapse the 15 different vintage prices for old gas into a single category that is subject to a single price ceiling (the ceiling for

post-1974/pre-NGPA old gas). Sections 104(b)(2) and 106(c) explicitly authorize the Commission to raise the ceiling price for old gas, as long as the higher ceiling is "just and reasonable within the meaning of the Natural Gas Act." The Commission explained in considerable detail why Order No. 451 is "just and reasonable": it remedies substantial distortions in the natural gas market caused by the prior system of vintage pricing, mitigates inequities among consumers resulting from their unequal access to lower-priced old gas, and removes production disincentives for an additional 11 trillion cubic feet of old gas. See Pet. 7-10. The court of appeals did not dispute these factual underpinnings for the Commission's action or otherwise find that the price ceiling prescribed by Order No. 451 does not satisfy the flexible "just and reasonable" standard as ordinarily applied under the NGA, which is the only limitation incorporated into Sections 104(b)(2) and 106(c) of the NGPA. Rather, the court held, based on scattered bits of legislative history and its own view of the "essence" of the legislative compromise that led to passage of the NGPA (Pet. App. 19a), that Sections 104(b)(2) and 106(c) froze the prior system of vintage pricing for old gas and therefore vest the Commission with only limited authority to increase the ceiling price for old gas.

Respondents do not attempt to defend this reasoning. Instead, they argue (Br. in Opp. 21-25) that the court of appeals did not really hold that the Commission exceeded its statutory authority under the NGPA, and that its ruling "does not depend primarily on the elimination of vintaging" (Br. in Opp. 21). As respondents now see it, the court below found Order No. 451 inconsistent with ordinary principles of "just and reasonable" rates under the NGA. This characterization of the ruling below is refuted by the unambiguous language of the court's opinion. Thus, the court: (1) expressed its agreement with respondents' submission that by "collaps[ing] the previous vintage system

and set[ting] a single higher than market price on old gas," the Commission "ignored congressional intent and exceeded its authority" under the NGPA (Pet. App. 16a, 17a); (2) stated that "Congress' intent was * * * to protect the interests of the consumer through the incorporation of a vintaged old gas pricing system '*as a significant feature of the NGPA's design*' " (*id.* at 22a); and held that Order No. 451, "by abrogating the vintage pricing structure, represents * * * an improper exercise by the Commission of its *limited* authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c)." Pet. App. 23a (emphasis added). By contrast, the portion of the majority's opinion that invalidates the pricing features of Order No. 451 (see Pet. App. 16a-23a) contains no discussion of the various factors on which the Commission relied in finding the higher ceiling consistent with ordinary "just and reasonable" principles under the NGA.[1]

b. Respondents themselves argue in this Court that Order No. 451 was wholly beyond the Commission's statutory authority. This is so, in their view, because the Order "deregulates" the price of old gas. Br. in Opp. 21-22, 24-25. Respondents are wrong. Order No. 451 subjects *all* old gas to a price ceiling – indeed, to the very price ceiling that was already in effect for one category of old gas at the time the Order was issued. Order No. 451 simply collapsed

[1] Respondents contend that the court below relied on the Commission's own statements to find that the new ceiling price does not comport with the "just and reasonable" standard of the NGA. See Br. in Opp. 21-22, citing Pet. App. 11a-13a & n.15. However, the portion of the opinion below describing the Commission's reasoning, cited by respondents, is not part of the court's ruling on the merits, which is contained in Part II of its opinion (entitled "Discussion"), but rather is part of the court's straightforward statement of the case, which is contained in Part I of its opinion (entitled "An Historical Perspective"). The omission of any similar discussion of the Commission's reasoning in the court's ruling on the merits reinforces the conclusion that its ruling does not rest on a disagreement with the Commission's application of ordinary "just and reasonable" principles.

15 different vintages into a single category subject to a single price ceiling. It is consistent in this regard with the Commission's various actions in the 1970s that revised (and even temporarily abandoned) the system of vintage pricing (see Pet. 4, 20-21; *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 330 (1983)) – including a directly parallel order that collapsed pre-1973 vintages into a single category that was subject to the highest ceiling price for the most recent vintage. See *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 841-842 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978). Then, as now, the Commission believed that some reliance on an incentive- or replacement-cost approach, rather than the purely historical-cost approach respondents urge, was appropriate for old gas, in order to spur production and to allocate some of the cost of replacing scarce resources on the consumers of old gas as well as new. The Commission's actions were uniformly sustained by this Court and the courts of appeals. See *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 320 (1974); *Tenneco*, 571 F.2d at 841-842; *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1058 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *Shell Oil Co.* v. *FPC*, 520 F.2d 1061, 1077-1078 (5th Cir. 1975), cert. denied, 426 U.S. 941 (1976); *Shell Oil Co.* v. *FPC*, 491 F.2d 82, 86-88 (5th Cir. 1974).

Because such flexibility under the "just and reasonable" standard and departures from the pure vintage-pricing approach were sustained under the NGA prior to enactment of the NGPA, Congress must have contemplated that the Commission could take similar action under Sections 104(b)(2) and 106(c), which incorporate the "just and reasonable" standard of the NGA. *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978). This Court has already concluded as much, observing that Sections 104(b)(2) and 106(c) of the NGPA "recognize[ ] that the ceiling may be too *low* and authorize[ ] the Commission to raise it whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333.

c. The premise of respondents' view that Order No. 451 is wholly beyond the Commission's statutory authority—that the Order "deregulates" the price of old gas—rests entirely on the fact that the ceiling price the Order prescribes is now higher than the prevailing market price for natural gas. See Br. in Opp. 21-22 & n.13, 24. But respondents cite no authority for the proposition that a ceiling price is not "just and reasonable" because it happens to be above (or below) the market price at any given time. To the contrary, as the Court stated in *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968):

> [T]he Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within a "zone of reasonableness" * * *. No other rule would be consonant with the broad responsibilities given to the Commission by Congress; it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests.

Respondents cannot escape this conclusion by attaching the label "deregulation" to the Commission's action. The fact remains that old gas is subject to a price ceiling that is the same as the ceiling carried forward by Congress for post-1974 old gas.

The weakness of respondents' position is further highlighted by their reliance (Br. in Opp. 23-25) on *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204 (1988). That decision in fact undermines their position. The Court there concluded that "[t]he plain meaning of the [NGPA] decides the issue presented." *Id.* at 209. The same is true here, because the "just and reasonable" standard, as consistently construed by the Commission and the courts prior to its incorporation into Sections 104(b)(2) and 106(c) of the NGPA, clearly supports Order No.

451. Moreover, the Court recognized in *Martin Exploration* that "by 1984 the market price of natural gas had plunged below the regulated price ceilings," 486 U.S. at 208, but it did not suggest that this phenomenon had resulted in the "deregulation" of natural gas. See *id.* at 209-211. And it would be ironic to conclude that this state of affairs is unlawful under statutory provisions that are intended in large part to benefit consumers, since the decline in the market price below the ceiling was of considerable benefit to consumers, and that decline presumably was spurred in part by the increased availability of old gas that resulted from Order No. 451. If there was any ambiguity concerning the scope of the Commission's authority in this regard under Sections 104(b)(2) and 106(c), *Chevron* required the court of appeals to defer to the Commission's reasonable interpretation.

2. Respondents argue (Br. in Opp. 25-27) that the court below correctly found the abandonment provisions of Order No. 451 invalid under Section 7(b) of the NGA, 15 U.S.C. 717f(b). This contention is without merit. Section 7(b) provides that "[no] natural-gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." These requirements were satisfied here: the Commission gave its permission in Order No. 451 for a producer to abandon sales upon the unsuccessful conclusion of the "good faith negotiation" (GFN) process established by the Order, and it did so based on a finding that the public convenience and necessity permit that result so that the gas can be made available to a willing purchaser. See Pet. 24. In respondents' view (Br. in Opp. 27), Section 7(b) requires the Commission "to make findings on specific transactions and to provide affected parties with the right to an individual hearing." However, as we have explained (Pet. 24-25), a hearing is

"due" under Section 7(b) only if there are disputed facts bearing on the appropriateness of abandonment under the governing standards prescribed by Order No. 451; legislative facts and questions of policy were properly addressed in the rulemaking proceedings.

Moreover, in contrast to the decision below, the D.C. Circuit has held that the Commission may specify in advance, by rule, the circumstances that "automatically trigger its approval of abandonment." *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1015 n.17 (1987), cert. denied, 485 U.S. 1006 (1988). Respondents attempt (Br. in Opp. 27) to distinguish *Associated Gas Distributors* on the ground that the purchasers there agreed to the reduced service. However, the D.C. Circuit did not rely on that factor. Moreover, under Order No. 451, a producer likewise cannot abandon service if the pipeline is willing to purchase the gas at the price proposed by the producer in the GFN negotiating process.[2]

3. In an effort to minimize the court of appeals' holding regarding take-or-pay clauses in existing contracts (see Pet. 25-26; Pet. App. 29a-32a), respondents claim (Br. in Opp. 29) that the court "did not order the Commission to do anything with respect to the take-or-pay issue." The court clearly held, however, that the Commission's failure to take action on the take-or-pay problem in connection with Order No. 451 was "arbitrary and unsupportable" (Pet. App. 31a-32a). In other words, the court made resolution of the take-or-pay issue a condition precedent to

[2] Respondents' reliance (Br. in Opp. 25-27) on *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), and *FPC* v. *Moss*, 424 U.S. 494 (1976), is to no avail. Neither of those decisions held or suggested that the Commission may not, as here, give its approval for abandonment at a future date upon the satisfaction of certain specified conditions. In the former case, there was no approval by the Commission at all, and in the latter, the Court held that the Commission could, upon a proper finding of public convenience and necessity, give advance approval of abandonment upon the occurrence of specified conditions.

the lawful promulgation of Order No. 451. See Pet. App. 57a-58a (Brown, J., dissenting). The consequence is to require the Commission to transform its proceedings on that Order into an omnibus proceeding to eradicate various market distortions in one fell swoop, even though the Commission *has* been addressing the take-or-pay issue in distinct rulemaking proceedings tailored to that purpose. See Pet. 26 n.10. This ruling is inconsistent with decisions recognizing that an agency has broad discretion to order its regulatory priorities and to select the appropriate vehicle in which to address them. See *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519, 543-545 (1978); *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 49-52 (1968); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1159-1160 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). Respondents do not answer our submission that under principles of administrative law applied in these cases, the court below could not prescribe such a condition precedent to the issuance of Order No. 451.

4. Respondents' effort (Br. in Opp. 16-19) to downplay the practical significance of the court of appeals' decision is without merit. Based on data in its own files, the Commission is aware of at least 1600 contracts that were negotiated or renegotiated pursuant to or in light of Order No. 451 or were entered into in reliance on the pre-granted abandonment authority. See Pet. 16, 26. The decision below calls into question the validity of those contracts, and if permitted to stand, it will generate widespread litigation in state courts as purchasers seek to rescind or revise renegotiated contracts or reinstate abandoned ones, and to the filing of numerous petitions with the Commission for refunds or other relief. On the basis of their own survey, the private petitioners estimate that the decision below calls into question an even greater number of contracts – more than 3000, covering 6.8 trillion cubic feet of old gas valued at approximately $13.7 billion – and that 1.6 trillion cubic feet of old gas, valued at $3.2 billion, have been redirected to new customers as a result of Order No. 451. See 89-1452 Pet. 3,

13, 17-18, 26-27. Under either estimate, the potential impact of the decision below is enormous.[3]

Respondents' contention (Br. in Opp. 16, 18) that the Natural Gas Wellhead Decontrol Act of 1989 renders this case unworthy of the Court's attention is equally without merit. First, contrary to respondents' assertion that the vindication of Order No. 451 "would only serve to frustrate and impede the transitional process that Congress created" in the Wellhead Decontrol Act (Br. in Opp. 18), Congress passed that Act because of its dissatisfaction with the same market distortions that led the Commission to adopt Order No. 451, and Congress acted on the premise that various administrative measures adopted by the Commission, including Order No. 451, had brought about lower prices and made decontrol possible. See Pet. 27-28. Second, although Section 2(b) of that Act, 103 Stat. 158, releases old gas from statutory price controls on January 1, 1993, it does not otherwise affect private contracts for the sale of natural gas, which are the product of negotiations between the parties. See *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 343 (1956). For this reason, the prospect of eventual decontrol does not eliminate the widespread uncertainty and disruption that the decision below creates for private contracts that were renegotiated, terminated, or entered into pursuant to or in light of Order No. 451.[4]

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[3] Respondents characterize (Br. in Opp. 17) the estimates by the Commission and the private petitioners as "widely divergent." In fact, however, there is no inconsistency between the two. We have been informed that the Commission's figure of 1600 affected contracts was based solely on contracts of which it is aware based on materials in its files. It did not purport to be a definitive or maximum figure, since many contracts might have been negotiated or renegotiated without being called to the Commission's attention. The private petitioners' survey presumably was more all-encompassing.

[4] Respondents point out (Br. in Opp. 12, 16, 18) that Section 2(a) of the 1989 Act, 103 Stat. 157-158, permits parties to negotiate higher prices if a contract is terminated or modified. They fail to acknowledge, however, that private parties enjoyed essentially the same right before that Act was passed, and they do not explain how a provision for voluntary negotiation of *new* contracts could reduce the uncertainty about the validity of *existing* contracts.

For the foregoing reasons and those stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

KENNETH W. STARR
Solicitor General

WILLIAM S. SCHERMAN
General Counsel
Federal Energy Regulatory Commission

MAY 1990